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TO RUEHC/SECSTATE WASHDC PRIORITY 1399
INFO RUEHUL/AMEMBASSY SEOUL 2898
RUEHMO/AMEMBASSY MOSCOW 1870
RUEHTA/AMEMBASSY ASTANA
RUEHBJ/AMEMBASSY BEIJING 5724
RUEHML/AMEMBASSY MANILA 1436
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RUEHKO/AMEMBASSY TOKYO 2610
RUEHBK/AMEMBASSY BANGKOK 1515
RUEHOT/AMEMBASSY OTTAWA 0489
RUEHBY/AMEMBASSY CANBERRA 0161
RUEHSH/AMCONSUL SHENYANG 0304
RUEHVK/AMCONSUL VLADIVOSTOK 0136
RUEHOK/AMCONSUL OSAKA KOBE 0036
RULSDMK/DEPT OF TRANSPORTATION WASHINGTON DC
RHEBAAA/DEPT OF ENERGY WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC 0679
RUCPODC/USDOC WASHDC 1358
RHEHNSC/NSC WASHDC
RUEKJCS/SECDEF WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

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STATE FOR EAP/CM AND EB/IFD/OIA
STATE PASS USTR, EXIM, OPIC, AND EPA
STATE PASS AID/ANE D. WINSTON
MILLENNIUM CHALLENGE CORP WASHDC FOR F. REID
TREASURY PASS USEDTS TO IMF, WORLD BANK
MANILA AND LONDON FOR USEDTS TO ADB, EBRD

E.O. 12958: N/A
TAGS: [ELTN](#) [ETRD](#) [PREL](#) [PGOV](#) [MG](#)
SUBJECT: MONGOLIAN GOVERNMENT'S REVOCATION OF MINING RIGHTS ROILS
INVESTMENT CLIMATE

SENSITIVE BUT UNCLASSIFIED - NOT FOR INTERNET DISTRIBUTION

¶1. (SBU) SUMMARY AND COMMENT: Late last week the Government of Mongolia (GOM) revoked the exploration licenses of 18 firms on 34 sites without prior warning, consultation, or any internal review of the action. The GOM claims that revocation is allowed under the newly amended minerals law. Charging that the GOM has acted against the letter and spirit of the law, firms and their legal advisors call the act "expropriation" of their rights and a complete violation of the GOM's explicit commitment to follow best practices and the rule of law. In any case the revocation has severely damaged Mongolia's reputation among many international investors, and some now question whether the GOM can act in good faith on any deal. At the March 2007 USG/GOM Trade and Investment Framework Agreement (TIFA) talks the GOM explicitly committed to support a best practice regime for mining in the face of industry and USG criticism of abuses under former Minister of Industry and Trade B. Jargalsaikhan. This latest action, expropriatory in nature, causes us to question that commitment. At this point, post will ask senior officials at the Ministry of Trade and Industry (MIT), the Mineral Resources and Petroleum Authority of Mongolia (MRPAM), and other relevant GOM agencies to: (a) explain the legal and regulatory basis of this decision, (b) emphasize the potential and real damage done to Mongolia's reputation among mining firms and equity investors, and, (c) encourage the GOM to find a way to walk back from a policy that has deeply disturbed investors and capital markets and which risks triggering U.S. expropriation sanctions. While much damage has been done to Mongolia's reputation, there are legal remedies available should the GOM not reverse its course. Post will continue to monitor the situation and report. END SUMMARY AND COMMENT.

What The GOM Did

¶2. (SBU) On Thursday, August 16, the Cadastral Office, which registers mining licenses and exploration rights and which is under the direct Authority of the Mineral Resources and Petroleum Authority of Mongolia (MRPAM), issued letters to 18 foreign and domestic firms revoking the exploration rights on 34 separate properties. These exploration rights covered uranium, coal, gold, potash, copper, and molybdenum deposits. For two Canadian firms with rights to uranium prospects in eastern Mongolia, the termination of rights, which they call expropriation, has been an unmitigated disaster. Both firms, listed on the Toronto Stock Exchange (TSX), have lost significant shareholder value, with one, Khan Resources, suffering a 60% drop in share value or US\$150 million in market capitalization. They doubt that they can recover the lost value, because future investors will turn away from Mongolia as too unstable and unreliable.

Impact Immediate - Turmoil

¶3. (SBU) The fallout from this decision is already harming Mongolia's reputation. Commoff has spoken with several in-bound US investors, among them Peabody Energy and Oaktree Capital, who have been spooked by actions they consider expropriatory or close to it. Investors from other nations are telling post the same thing. As one private equity firm noted, the action could not come at a worse time for Mongolia, just at the very moment that they and other firms were seriously considering investing hundreds of million of dollars into resource extraction.

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GOM's Explanation...

¶4. (SBU) The Cadastral Office justified its seizure, citing a report produced by the State Audit Committee (SAC) for the Ministry of Industry and Trade (MIT) in which the SAC criticized MIT for allowing firms exploration rights on deposits which socialist era exploration had made resource estimates. The SAC referred to a provision of the recently amended Minerals Law of Mongolia (2006), Article 60. Article 60 states that the GOM shall not issue an exploration license for land on which the state has (1) conducted exploration in the past and (2) registered reserves with the State Mineral Reserve Register administered by MIT. SAC argued that any exploration rights should be immediately terminated, with the rights reverting to the GOM which could dispose of them by tender. The SAC report criticized MRPAM and MIT for not terminating these rights. Upon receiving this critique, unknown officials at MIT apparently ordered MRPAM's Cadastral Office to revoke the rights with immediate effect, which the office did.

... Falls Short On Law and Logic

¶4. (SBU) Lawyers familiar with Article 60 criticized the SAC interpretation of the provision and MIT and MRPAM's handling of the event as against both the letter and spirit of the amended law. First, they noted that they had these exploration rights long before the law was amended and that Mongolia should honor its prior commitments. Failing that, they argue the GOM should honor the spirit and letter of the provisions, which was not void rights but to encourage mining at sites that the GOM believed to be sufficiently explored to go into production without further exploration. On such deposits, Article 60 would allow a firm to convert an exploration license to a mining license immediately. Although disagreeing with the GOM about the quality of past exploration and reserve estimates, firms and their legal advisors signaled that they could live with such a provision, which they argue is a far cry from SAC determination that the provision allows for immediate confiscation of rights.

¶5. (SBU) Firms and their legal advisors also noted that MRPAM's action flies in the face of every commitment the GOM has made to

have an open and transparent system consistent with international best practices and the rule of law. There was no public review or comment of the SAC audit. There is no indication that MIT or MRPAM consulted any legal opinion regarding SAC's views or that the SAC consulted any expert in or out of the GOM about its interpretation of Article 60. No one responsible for this decision has been available for comment or explanation. MRPAM' senior officers are not answering their phones, nor are officials from MIT.

Snatch and Resell?

16. (SBU) Adding to the confusion is a fear that elements within the GOM are consciously abusing the system to despoil one set of right's holders so that they can turn around and sell those rights to others. One attorney reported to post that immediately after the revocation letters went out to clients, calls came from Kazakhstan businessmen about whether the clients were interested in selling their proprieties to them. The attorney noted that the Kazakhs had precise details on the exploration rights, which they could only have got from MRPAM or MIT. (Note: President Enkhbayar visited

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Kazakhstan the previous week. Septel to follow.)

Bottom Line: Damage Done But Remedies Remain

17. (SBU) The firms have not given up hope for restoration of their rights. First, the decision is subject to grievance through the MRPAM Chair; however, this gentleman left for Germany at the same time the decision was rendered by his Cadastral Office, delaying any grievance procedure. Second, if MRPAM fails to reverse its decision, the firms have recourse to the court system, which of late has been highly critical of GOM decisions related to mining, overturning GOM actions on the grounds that they are inconsistent with the law and regulation controlling mining.

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